

Internal Revenue Service

Number: **200952015**

Release Date: 12/24/2009

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:BO3

PLR-118552-09

Date:

September 23, 2009

X =

Y =

a =

b =

c =

d =

Trust =

d1 =

d2 =

d3 =

State =

Dear :

This letter responds to your letter dated April 3, 2009, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X was incorporated under the laws of State on d1. X elected to be an S corporation effective d1. On d2, a, b, c, and d were the only shareholders of X until a transferred a portion of his shares and b transferred all of her shares of X's stock to Trust. X represents that Trust is not a trust described in § 1361(c)(2). Consequently, X's S corporation election terminated on d2. On d3, Y acquired all of the stock of X pursuant to a stock purchase agreement that obligates Y and a, c, d and Trust to make an election under § 338(h)(10) to treat the sale of X's stock as an asset sale and liquidation of X. Because b had transferred all of her stock to Trust on d2, b was not a party to the stock purchase agreement and did not join in the § 338(h)(10) election.

X represents that there was no intent to terminate X's S corporation election and that the termination of X's S corporation election was inadvertent and not motivated by tax avoidance or retroactive tax planning. For all taxable years, X and X's shareholders' income was reported consistent with X qualifying as an S corporation. X and its shareholders have not yet filed a return for the taxable year that includes d2 and d3. X and X's shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. The Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was terminated on d2. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from d2 through d3, the date it ceases to exist pursuant to Treas. Reg. § 1.338(h)(10)-1, unless X's S corporation election is otherwise terminated under § 1362(d) and provided that the following conditions are met.

During the period d2 through d3, a and b are treated as the shareholders of X with respect to the shares of X stock transferred to Trust. Accordingly, a, b, c, and d must join with Y to make a valid § 338(h)(10) election. These taxpayers must obtain an extension of time to make the § 338(h)(10) election (see Rev. Proc. 2003-33, 2003-1 C.B. 803). They must also include in their income their pro rata share of separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made (or deemed made) by X as provided in § 1368 consistent with a and b being the shareholders of X with respect to the X stock transferred to Trust. In addition, a and b must file their 200 federal income tax returns consistent with (1) a and b retaining ownership of the shares of X stock transferred to Trust until its acquisition by Y on d3, (2) a and b selling those shares of stock to Y on d3, and (3) a and b transferring the cash sales proceeds of those shares of stock (rather than the shares of stock) to Trust.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the Cincinnati Service Center that its S corporation election has terminated.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
Copy for Section 6110 purposes